



Franchise and Excise Tax Guide

January 2008

FRANCHISE AND EXCISE TAXES

Dear Tennessee Taxpayer,

This publication is designed to help taxpayers better understand the Tennessee franchise and excise taxes, including the collection and remittance of the taxes. The franchise and excise taxes are essential parts of the Tennessee tax structure. You may find compliance easier when you know more about the taxes. Please take time to acquaint yourself with how these taxes apply to you. This franchise and excise tax guide is intended as an informal reference for taxpayers who wish to gain a better understanding of Tennessee franchise and excise tax requirements. It is not an all-inclusive document. The tax guide is not intended as a substitute for Tennessee franchise and excise statutes or Rules and Regulations, nor is it intended to be a statement of Department of Revenue policy. The information in this guide is current as of the date of publication but could change as the tax laws, their interpretation, and their application do change from time to time because of legislative action, reviews, and court decisions.

Periodically, registered taxpayers may be mailed information letters with updates on tax laws and policies. Be sure to read any letter you receive carefully; this information may save you time and money. Informational publications are also available for specific industries. Contact the Taxpayer and Vehicle Services Division to obtain these publications.

The Department of Revenue offers a toll-free tax information line for Tennessee taxpayers. The number is (800) 342-1003. If calling from Nashville or out-of-state, you may call (615) 253-0600. The Department of Revenue also offers a telecommunications device for the deaf (TDD) line at (615) 741-7398.

In addition, the Department of Revenue offers a HOTLINE number for the exclusive use of the tax practitioner. In-state practitioners may call toll-free (800) 397-8395; from Nashville and out-of-state, call (615) 253-0700.

If you have questions, please do not hesitate to contact any of the offices listed below.

Sincerely,

Taxpayer and Vehicle Services Division

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The excise tax is a tax imposed on the privilege of doing business in Tennessee. General partnerships and sole proprietorships are not subject to the tax. The tax is based on net earnings or income for the tax year. [Tenn. Code Ann. Section 67-4-2007]

The franchise tax is also levied upon the privilege of doing business in Tennessee and is based on the greater of net worth or the book value of real or tangible personal property owned or used. For this purpose, net worth or property values at the end of the taxable period are used. [Tenn. Code Ann. Section 67-4-2104]

Both taxes are state taxes for state purposes only. No county, municipality, or taxing district shall have power to levy like taxes.

Although the franchise and excise taxes are two separate taxes, the intention of the state legislature, and the policy of the Department of Revenue, is that they are part of the same taxing scheme. Generally, any taxpayer that is liable for one will be liable for both. The use of the terms “franchise and excise tax” or “the tax” in this publication will indicate applicability to both taxes. Persons liable for the tax will register for both on one form and must file returns on one form. The taxable periods for both the franchise and excise taxes are always coincidental. A return is required for every fiscal closing of the corporate books of each taxpayer and must be filed coincidentally with each federal return filing period.

Who Is Liable?

Any person doing business in Tennessee is liable for the franchise and excise tax. In this regard, “person” or “taxpayer” means every corporation, subchapter S corporation, Limited Liability Company, professional limited liability company, registered limited liability partnership, professional registered limited liability partnership, limited partnership, cooperative, joint-stock association, business trust, regulated investment company, real estate investment trust, state-chartered or national bank, or state-chartered or federally chartered savings and loan association. [Tenn. Code Ann. Section 67-4-2004(16)]

A person doing business in Tennessee without incorporating, domesticating, qualifying, or otherwise registering in Tennessee, or doing business in Tennessee while its charter or other registration is forfeited, revoked, or suspended, will not be relieved from filing a return and paying the tax for each tax year that it does business in Tennessee. [Tenn. Code Ann. Sections 67-4-2105(d), 2007(b)]

If a taxpayer dissolves without settling its franchise and excise tax obligations, the officers, stockholders, partners, members, principals, or employees may be held liable for the tax to the extent that they received any of the entity’s corporate property in the liquidation process. [Tenn. Code Ann. Sections 67-4-2016, 2117]

Registration

All persons subject to the franchise and excise tax will register with the Department of Revenue by completing and filing the registration form prescribed by the department. This form will be filed within 15 days after the date the person becomes subject to the tax. Persons registered prior to the 1999 revision of the franchise and excise tax, or who have filed a return under prior law, are not required to register again for the tax. [Tenn. Code Ann. Section 67-4-2003(c)]

Secretary of State Requirements

To obtain a corporate charter, articles of organization, a certificate of limited partnership, or a certificate of authority for out-of-state corporations, the appropriate forms and fees must be filed with the Tennessee Secretary of State. Any amendments must also be filed with the Secretary of State’s office. All corporations, limited liability companies, and limited partnerships qualified with the Tennessee Secretary of State must file an annual report and pay a filing fee with that office. The report is due on the first day of the fourth month following the corporation’s fiscal closing.

How to Apply

The most efficient method of applying for franchise and excise tax registration is to visit one of the Department of Revenue offices listed on

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THE FRANCHISE AND EXCISE TAXES (cont'd)

the first page of this publication. Trained personnel are available there to explain Tennessee's tax system and to answer your questions. If you are unable to visit one of the offices, you may mail the Application for Franchise, Excise Tax Registration form to any of the offices listed.

Whether you complete the Application for Registration form in person or by mail, you will need the following information to complete it:

- + The name, address, and phone number of the business, principal owners, officers, members, or partners, and the person making the application.
- + The Social Security Numbers of the principal owners, partners, members, or officers.
- + The Federal Employer's Identification Number (FEIN) issued by the U.S. Internal Revenue Service if you pay wages to anyone other than yourself.
- + A description of the business, the type of ownership, a brief explanation of the nature of the business, and, if the business is a corporation, the date of incorporation or domestication in Tennessee.
- + The Secretary of State control number if the business is registered with the Secretary of State.
- + The signature of an owner, officer, member, or partner on the application.

Nexus of Out-of-State Businesses [Tenn. Code Ann. Section 67-4-2004]

Out-of-state businesses must register with the Department of Revenue for payment of the franchise and excise taxes if they have "nexus" in Tennessee. Generally, businesses are considered to have nexus if they:

- + Have an office, distribution point, sales room, warehouse, or any other temporary or permanent place of business in Tennessee, or
- + Conduct any business activities in Tennessee that go beyond the mere solicitation of orders for sales of tangible personal property that are accepted, approved, and shipped from outside Tennessee, provided there is physical presence in Tennessee. (Applies to excise tax only; nexus exists for franchise tax through order solicitation.)

The above named activities are not intended to be all-inclusive, and it would be possible for a business engaged in an activity not listed above to have sufficient nexus in Tennessee to be subject to Tennessee franchise and excise taxes.

The law provides some exceptions to the general nexus rule. These exceptions include:

- + The presence of employees, product samples, or promotional materials at trade shows or conventions, for no more than 20 days each calendar year, providing the employees' activities are limited to taking orders, purchasing goods, or maintaining the show.
- + Activities by book and magazine publishers with Tennessee printers, when limited to activities having to do with the printing, storage, labeling, or delivery by mail or common carrier of their materials; maintenance of raw materials; production; or quality control. This exception doesn't apply if the publisher and printer are affiliated.
- + The physical presence of equipment, tooling, inventory, and employees when the taxpayer's employees are not engaged in the pursuit of a market in Tennessee; the equipment and tools are not used by an affiliated entity; the taxpayer does not have control over the work done by the in-state entity; and the extent of the value of the property, the number of employees, and the number of days the employees are in Tennessee is minimal.
- + The temporary presence of employees solely for the purpose of purchasing goods from Tennessee vendors for out-of-state use. This presence shall not exceed 30 days per calendar year, and the out-of-state employer shall not provide an office for these employees.

Out-of-state corporations doing business in Tennessee are subject to franchise and excise taxes even if they are not incorporated or domesticated in Tennessee.

Classifications of Businesses [Tenn. Code Ann. Section 67-4-2007]

Businesses will be classified as corporations, partnerships, or other types of business entities consistent with the way they are classified for federal income tax purposes and taxed accordingly. Entities disregarded for federal income tax purposes, except limited liability companies whose single member is a corporation, will not be disregarded for

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THE FRANCHISE AND EXCISE TAXES (cont'd)

Tennessee franchise and excise tax purposes. Except for unitary groups of financial institutions or business entities that have been required or permitted to file franchise and excise tax returns on a combined, consolidated, or separate accounting basis, each taxpayer will be considered an separate and single business entity for Tennessee franchise and excise tax purposes. Each entity will file its Tennessee franchise and excise tax return reflecting only its own business activities.

Financial Institutions [Tenn. Code Ann. Sections 67-4-2004 and 2105]

A financial institution is not subject to franchise and excise taxes if it has no physical presence in Tennessee.

A financial institution is not considered to be conducting the business of a financial institution in this state if its only activity is the ownership of an interest in one or more of the following types of property, including activities that are required to acquire or dispose of the property, to service the property, to collect income from the property, or to acquire or liquidate collateral relating to the property.

- + A real estate mortgage investment conduit, real estate investment trust, or regulated investment company as defined by the Internal Revenue Service.
- + A loan-backed security representing ownership or participation in a pool of promissory notes or certificates of interest that provide for payments, or reasonable projections of payments, on the notes or certificates.
- + A loan, lease, note, or other asset attributed to this state in which the payment obligations were solicited and entered into by an independent person not acting on behalf of the owner.
- + The right to service or collect income from a loan or other asset from which interest on the loan or other asset is attributed to this state and in which the payment obligations were solicited and entered into by an independent person that is not acting on behalf of the owner.

- + Demand deposit clearing accounts, federal funds, certificates of deposit, and other similar wholesale banking instruments issued by other financial institutions.
- + Securities.
- + Any intangible, tangible, real, or personal property acquired in satisfaction, fully or in part, of any a payment obligation that is in default, secured or unsecured, if the ownership of the interest would be exempt otherwise.

Dissolving a Corporation

Before a taxpayer can terminate its charter, articles of organization, or certificate of limited partnership, or withdraw its certificate of authority or other similar document, a tax clearance certificate must be issued by the Department of Revenue. In order to receive a tax clearance certificate, a taxpayer must file all returns to date and a final franchise and excise tax return through the date of liquidation or the date the taxpayer ceased operations in Tennessee.

A schedule of liquidation, distribution, or disposition of all assets must accompany the final return. The final franchise tax will be determined by using the balance sheet values immediately preceding liquidation. [Rule 1320-6-1-.11]

When these requirements have been met, the Department of Revenue will be able to issue the tax clearance certificate for termination or withdrawal. The certificate will be mailed to the taxpayer's mailing address unless otherwise specified. To complete the termination or withdrawal process, the taxpayer must contact the Tennessee Secretary of State's office for that office's requirements. The tax clearance certificate is valid for 45 days from the date of issuance.

It is the commissioner's responsibility to collect the franchise and excise tax due, plus any penalties and interest, from any officer, stockholder, partner, member, principal, or employee of a taxpayer that has ceased business without paying the tax, if such person has received property of the defunct business. The amount of tax that may be collected in this situation may not exceed the value of the property received by the person from whom collection is sought. [Tenn. Code Ann. Section 67-4-2117]

FRANCHISE AND EXCISE TAXES

THE FRANCHISE AND EXCISE TAXES (cont'd)

If a taxpayer goes out of business or otherwise ceases to exist during a year, the taxpayer is not entitled to prorate the excise tax liability due. The franchise tax liability may be prorated only on a return covering a tax period of less than 12 months.

Effective Dates

The effective dates of the Tax Revision and Reform Act of 1999 vary depending on the business entity and the provisions of the Act. As a general rule, the new franchise and excise tax went into effect for tax years beginning on or after July 1, 1999. As most businesses use the calendar year for their tax year, most were affected by the new law on January 1, 2000.

Limited liability companies, limited partnerships, and limited liability partnerships are exceptions to the general rule if one or more corporations, subject to the franchise and excise taxes under prior law, directly or indirectly, had in the aggregate an 80% or more ownership interest at any time after June 30, 1998. For these entities, the new law went into effect for tax years ending on or after June 30, 1999.

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EXEMPT ENTITIES

The law exempts a number of entities from the franchise and excise tax:

Corporations organized in Tennessee, whose sole purpose is furthering industrial development in Tennessee communities, whose stockholders receive no income other than interest on money invested in the corporation, and whose officers receive no compensation. [Tenn. Code Ann. Section 67-4-2008(a)(1)]

Corporations organized for the purpose of erecting or owning a meeting place for more than one Masonic lodge, lodge of Odd Fellows, or similar lodge; which could obtain general welfare charters; and whose stock is owned by lodges participating in the common meeting place. Commercial rental income received by such corporations is not tax exempt. [Tenn. Code Ann. Section 67-4-2008(a)(2)]

Regulated investment companies or funds organized as unit investment trusts, taxable as grantor trusts under federal law, and whose investment value consists of at least 75% government bonds of the United States, the state of Tennessee, or any county, municipal, or political subdivision of the state. [Tenn. Code Ann. Section 67-4-2008(a)(3)]

Federal and state credit unions, production credit associations, and investment companies organized under state law. [Tenn. Code Ann. Section 67-4-2008(a)(4)]

Certain venture capital funds dealing primarily in trading securities in non-publicly traded companies on its own behalf. The capital of the fund may be derived from investments by one or more affiliates if such affiliates also qualify as venture capital funds. [Tenn. Code Ann. Section 67-4-2008(a)(5)]

Certain limited liability companies, limited partnerships, and limited liability partnerships, the activities of which are at least 66% farming or holding personal residences where one or more of its partners or members reside. [Tenn. Code Ann. Section 67-4-2008(a)(6)]

Limited liability companies, limited liability partnerships, or limited partnerships existing on May 1, 1999, that were at least 98% owned by corporate members of an affiliated group defined

in 26 USC Section 1504(a); were formed and operated for the purpose of acquiring notes and other evidence of indebtedness from its members; the assets of which serve as security for third party borrowings or indebtedness; had at least 80% of the income from these instruments included in the income of a corporation doing business in Tennessee; and were subject to apportionment rules. [Tenn. Code Ann. Section 67-4-2008(a)(7)]

Limited liability companies, limited liability partnerships, or limited partnerships, all of whose members or partners are fully liable for the debts, obligations, and liabilities of the entity, and who have filed appropriate documentation with the office of the Secretary of State prior to the first day of the taxable year. However, in some instances, a secondary level of limited liability entities may be formed between the initial limited liability entity and the individual owners in an attempt to avoid the franchise and excise taxes while still providing limited liability to the individual owners or partners.

For tax periods ending on or after July 1, 2005, members or partners of a limited liability entity may make an election for the entity to be treated as an exempt "obligated entity." The members or partners making this election must file the required documentation with the Secretary of State to become fully liable for the debts, obligations, and liabilities of the entity and are referred to as "obligated members." In the event that any obligated member or any owner of an obligated member, whether such ownership is in whole, in part, direct, or indirect, provides limited liability protection, the obligated member entity is liable for franchise and excise taxes on the portion of income and equity attributable to such obligated member.

This exemption shall not apply to any of the eligible limited liability entities that are owned in whole or in part, directly or indirectly, by a corporation other than a non-profit corporation. [Tenn. Code Ann. Section 67-4-2008(a)(9)]

Entities, classified as partnerships or trusts under 26 USC Section 7701, or that have elected to be treated as a REMIC or FASIT entity, whose sole purpose is the asset-backed securitization of debt obligations. [Tenn. Code Ann. Section 67-4-2008(a)(10)]

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EXEMPT ENTITIES (cont'd)

Non-corporate entities that are at least 95% family owned. At least 66.67% of the entity's income must be derived from activities that produce passive investment income, or from a combination of the production of passive investment income and farming as defined by statute. Previously, only passive investment income was qualifying. These entities must certify their eligibility with the Department to receive the exemption. [Tenn. Code Ann. Section 67-4-2008(a)(11)]

Franchise and excise taxes are not applicable to nonprofit corporations as defined by law. Nonprofit corporations must file an annual report with the Secretary of State and pay the corporate filing fee. However, any nonprofit entity with income from activities that are not related to the reason it was granted nonprofit status is liable for the franchise and excise taxes on that income. [Tenn. Code Ann. Section 67-4-2007]

Effective for tax periods ending on or after June 30, 2003, Limited Partnerships and Limited Liability Companies organized exclusively for the purpose of providing affordable housing are exempt from franchise and excise taxes if the entity receives an allocation of low-income housing tax credits pursuant to Section 42 of the Internal Revenue Code (IRC) of 1986 and has in effect an "extended low-income housing commitment" as defined in Internal Revenue Code Section 42(h)(6)(B) with respect to each residential building owned by the entity for the period covered by the return. [Tenn. Code Ann. Section 67-4-2008(a)(8)]

Effective for tax periods ending on or after September 1, 2003, a corporation or limited liability company is exempt from the franchise and excise taxes if it is directly or indirectly owned and controlled by a nonprofit entity, is organized for the purpose of preserving or rehabilitating a historic property listed on the National Register of Historic Places, and the controlling nonprofit entity has received approval from the U.S. Department of the Interior National Park Service. In order to qualify for exemption, the nonprofit entity must directly or indirectly hold not less than 51% of the corporation or limited liability company's ownership interest and voting control, and the historic property must be used in the performance of the exempt activity or function of

the controlling nonprofit entity. [Tenn. Code Ann. Section 67-4-2008(a)(13)]

Diversified investing funds are exempt from franchise and excise taxes if the fund is a limited partnership, limited liability partnership, or limited liability company that is formed and operated for the purpose of buying, holding, or selling qualified investment securities on its own behalf. The capital of the fund must be primarily derived from investments by entities or individuals that are not affiliated with the fund. At least 90% of the fund's income must consist of interest, dividends, and gains from the sale or exchange of such investment securities. [Tenn. Code Ann. Section 67-4-2008(a)(12)]

Real Estate Investment Trusts

Prior to June 27, 2006, to the extent owned by real estate investment trusts, entities treated as partnerships for federal income tax purposes were exempt from the franchise and excise taxes.

Effective June 27, 2006, the franchise tax exemption for an entity that is treated as a partnership for federal income tax purposes and that is wholly owned, directly or indirectly, by a real estate investment trust was removed. The minimum franchise tax measure is extended based on the actual value of real or tangible property owned or used in Tennessee to an entity treated as a partnership for federal tax purposes and in which a real estate investment trust directly or indirectly owns a majority interest.

Also eliminated are the provisions relating to the computation of the net earnings or net loss of pass-through entity that is directly or indirectly owned by a real estate investment trust. Any entity treated as a partnership for federal tax purposes that directly or indirectly distributes 100 percent of its net earnings or net losses to a publicly traded real estate investment trust is exempt from the excise tax. A "publicly traded real estate investment trust" is defined as an entity that has an election in effect under Section 856 of the Internal Revenue Code, and that files with the Securities and Exchange Commission and whose shares are traded on a national stock exchange. For an entity that does not directly or indirectly distribute 100 % of its net earnings or net losses to a publicly traded real estate investment trust, the entity is exempt only to the

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EXEMPT ENTITIES (cont'd)

extent of the distribution to the publicly traded real estate investment trust. [Tenn. Code Ann. Sections 67-4-2019]

Insurance Companies [Tenn. Code Ann. Section 67-4-2009]

For the tax year beginning on or after December 15, 2002, and all subsequent years, the franchise and excise tax is no longer applicable to insurance companies that are subject to payment of the gross premiums tax.

Previously, insurance companies were allowed a credit for the net amount of gross premiums tax paid in the corresponding tax year. This did not include the gross premiums receipts tax paid by fire insurance companies for the purpose of executing the fire marshal law.

To the extent any franchise and excise tax liability remained after the application of the gross premiums tax credit, the remaining franchise and excise tax liabilities were reduced by an increasing percentage each year. For the tax year beginning on or after December 15, 2000, the reduction was 60%. For the tax year beginning on or after December 15, 2001, the liability was reduced by 80%.

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THE FRANCHISE TAX

The Measure of the Tax

The franchise tax rate is 25 cents per \$100, or major fraction thereof, of a taxpayer's net worth at the close of the tax year covered by the required return. The minimum franchise tax payable each year is \$100. A taxable business that is inactive or has had its charter or other registration forfeited, revoked, or suspended, but has not been dissolved or otherwise properly terminated, is not relieved from filing a return and paying the minimum franchise and excise tax. [Tenn. Code Ann. Sections 67-4-2106 and 2119]

The measure of the tax levied will not be less than the actual book value (cost less accumulated depreciation) of the real and tangible property owned or used in Tennessee, excluding exempt inventory and two thirds of the capital investment used to qualify for the jobs tax credit. The value of any property under construction and not actually utilized by the taxpayer will not be included in the tax base. [Tenn. Code Ann. Section 67-4-2108(a)]

The value of rental property will be determined by multiplying the net annual rental by the following multiples: real property - 8; machinery and equipment that is used in manufacturing - 3; furniture and office machinery and equipment - 2; delivery or mobile equipment - 1. [Tenn. Code Ann. Section 67-4-2108(a)(3)]

Property that is used primarily for air or water pollution control or treatment of hazardous waste, certified by the appropriate government authority as necessary to meet the requirements of state, federal, or local law, will not be included in the franchise tax minimum measure. [Tenn. Code Ann. Section 67-4-2108(5)]

The value of owned or leased mobile property, located both in and outside Tennessee during a tax period, will be determined on the basis of the total percentage of time this property is in the state during the tax period. The value of an automobile or truck assigned to a traveling employee will be considered in Tennessee if the vehicle is licensed in Tennessee or if the employee's compensation is assigned to Tennessee for purposes of the taxpayer's apportionment formula payroll factor. [Tenn. Code Ann. Section 67-4-2108(4)]

Except for unitary groups of financial institutions, each taxpayer is treated as a separate entity. In the case of consolidations, mergers, or like events, a tax credit incurred by a predecessor will not be allowed as a deduction on the tax return filed by a succeeding taxpayer. However, if a taxpayer merges out of existence into a successor taxpayer that has no income, expenses, assets, liabilities, equity, or net worth, the successor taxpayer may carry over any qualified credit deduction accrued to the predecessor. [Tenn. Code Ann. Sections 67-4-2109(e)(1) and (e)(2)]

A unitary group of financial institutions may take any qualified credit generated by any group member in existence as a member of the group at the end of the year provided that the credit has not previously been taken. [Tenn. Code Ann. Section 67-4-2109(e)(5)]

Net Worth

For taxpayers filing on a separate entity basis, "net worth" is defined as the difference between a taxpayer's total assets less its total liabilities. If the taxpayer does not maintain its books and records in accordance with generally accepted accounting principles, net worth will be computed according to the accounting method used by the taxpayer for federal tax purposes, so long as the method fairly reflects the taxpayer's net worth for purposes of the franchise tax. For taxpayers required by this part to file as a unitary group on a combined basis, "net worth" is defined as the difference between each such taxpayer's total assets less its total liabilities computed in accordance with generally accepted accounting principles. [Tenn. Code Ann. Section 67-4-2106(b)]

Effective for tax periods beginning on or after January 1, 2004, the deduction from a taxpayer's net worth base for the value of stock held in companies doing business in Tennessee has been repealed and replaced with a voluntary election to calculate the net worth base for franchise tax purposes on a consolidated basis. Once made, the election is binding for a minimum of 5 years. Taxpayers continue to pay on the greater of apportioned net worth or the value of real and tangible personal property in Tennessee regardless of the method that is used to arrive at the apportioned net worth. [Tenn. Code Ann. Section 67-6-2103(d)]

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THE FRANCHISE TAX (cont'd)

However, an affiliated group will not be allowed to elect to compute net worth on a consolidated basis unless all members of the group close their taxable year on the same date. If a member exits the consolidated group during a tax year because of a change in ownership, merger, or liquidation of the member, the member exiting the group will be excluded from the group and will compute its net worth individually. [Tenn. Code Ann. Section 67-4-2103(d)]

Tenn. Code Ann. Section 67-4-2004(1) provides a uniform definition of an “affiliate” for franchise tax and excise tax purposes. An “affiliate” is: (1) an entity in which the taxpayer, directly or indirectly, has more than a 50% ownership interest; (2) an entity that, directly or indirectly, has more than a 50% ownership interest in the taxpayer; or (3) an entity in which an entity described in (2) directly or indirectly has more than a 50% ownership interest. A noncorporate entity is more than 50% owned if, upon liquidation, more than 50% of the assets of the noncorporate entity directly or indirectly accrue to the entity having the ownership interest.

For purposes of calculating the value of real and tangible personal property for Schedule G, railroad companies may value such property in accordance with the method used for federal tax purposes so long as the method used for federal tax purposes fairly reflects the property’s actual value. [Tenn. Code Ann. Section 67-4-2108(a)(3)]

The franchise tax imposed on any manufacturer, one whose principal business is fabricating or processing tangible personal property for resale and use or consumption off the premises, will be assessed only on the first \$2 billion of apportioned net worth or real and tangible personal property owned or used in Tennessee. [Tenn. Code Ann. Section 67-4-2121]

Clarification of Finished Goods Inventory

Effective for tax years beginning on or after January 1, 2004, the definition of finished goods inventory for franchise tax purposes has been clarified. In 1995, a provision was enacted to encourage the development of manufacturing, warehousing, and distribution facilities in Tennessee by setting a cap on the value of

finished goods inventory included in the taxpayer’s franchise tax base minimum measure. The new provision clarifies the incentive by providing that such inventory must be held at a manufacturing, warehousing, or distribution facility rather than at a facility where retail sales are made to customers. [Tenn. Code Ann. Section 67-4-2108(a)(6)(C)]

Adjustments

For tax periods beginning on or after January 1, 2004, the provision under which the value of an interest, determined in accordance with generally accepted accounting principles, which is held by one taxpayer in any other taxpayer paying the franchise tax, or the gross premiums tax levied under either Tenn. Code Ann. Sections 56-4-205 or 56-4-206, and doing business in this state, could be deducted from the franchise tax of the first taxpayer was repealed. This provision was replaced with the option to voluntarily elect to calculate the net worth base for franchise tax purposes on a consolidated basis. [Tenn. Code Ann. Section 67-4-2107(b)]

If a corporation whose capital stock is inadequate for its business needs is extended credit or has indebtedness to, or guaranteed by, a parent or affiliated corporation, the indebtedness must be included in computation of the corporation’s net worth franchise tax base. [Tenn. Code Ann. Section 67-4-2107(c)(1)]

Exemptions

Exempt inventory may be excluded from the minimum measure of the franchise tax. “Exempt inventory” means that portion of a taxpayer’s finished goods inventory in excess of \$30 million, for fiscal years beginning on or after July 15, 1998, that would otherwise be included in the minimum measure of the taxpayer’s franchise tax. [Tenn. Code Ann. Section 67-4-2108(a)(6)(B)]

Exempt required capital investments may also be excluded from the minimum measure of the franchise tax. “Exempt required capital investments” means two thirds of the value of all capital investments that are the basis for the taxpayer’s entitlement to the job tax credit under Tenn. Code Ann. Sections 67-4-2109(c)(2)(G) and (H). Under these provisions, certain capital investments in excess of \$1 billion or \$500

FRANCHISE AND EXCISE TAXES

THE FRANCHISE TAX (cont'd)

million, as the case may be, qualify taxpayers to take tax credits for certain qualifying jobs created as a result of such investment enterprises. [Tenn. Code Ann. Section 67-4-2108(a)(1)(G)]

Partnerships, for federal income tax purposes, wholly owned, directly or indirectly, by a real estate investment trust, will be exempt from the payment of the franchise tax. Such entities partially owned by a real estate investment trust will be exempt from the tax imposed by this part to the extent that they are owned by the real estate investment trust. These entities will file franchise and excise tax returns as required and compute the franchise tax as though they were not partially exempt. The franchise tax will then be multiplied by the percentage of ownership by entities that are not real estate investment trusts; the result will be the franchise tax owed. [Tenn. Code Ann. Section 67-4-2108(b)]

FRANCHISE AND EXCISE TAXES

THE EXCISE TAX

The Measure of the Tax

All persons, except those with nonprofit status or otherwise exempt, are subject to a 6.5% corporate excise tax on the net earnings from business done in Tennessee for the fiscal year. This tax is in addition to any other taxes assessed under state law. Nonprofit persons and other exempt entities will be subject to the excise tax on net earnings in Tennessee from all activities unrelated to and outside the scope of the activities that give them exempt status.

Except for unitary groups of financial institutions and business entities that have been required or permitted to file excise tax returns on a combined, consolidated, or separate accounting basis, each taxpayer is treated as a separate entity and must file its excise tax return on a separate entity basis, reflecting only its own business activities even though it may have filed a consolidated federal income tax return. [Tenn. Code Ann. Section 67-4-2007]

In the case of consolidations, mergers, or like events, no carryover loss by the previous taxpayer will be allowed as a deduction against the net earnings of the succeeding taxpayer. However, if the previous taxpayer merges out of existence and into a surviving successor taxpayer that has no income, expenses, assets, liabilities, equity, or net worth, the survivor of the merger may take any qualified loss carryover incurred by the predecessor. [Tenn. Code Ann. Section 67-4-2006(c)(3)]

A unitary group of financial institutions may take qualified loss carryovers of any group member that is in existence as a member of the group at the end of the tax year if such loss has not been previously taken by the member itself or by another unitary group of financial institutions entitled to the loss when the member was part of its unitary group. [Tenn. Code Ann. Section 67-4-2006(c)(4)]

Net Earnings

Net earnings (losses) are defined as federal taxable income (loss), before the net operating

loss deduction and special deductions provided for in the Internal Revenue Code, plus or minus certain additions and deductions provided by state law. Some examples of adjustments are:

Additions to Federal Taxable Income before the Net Operating Loss Deduction and Special Deductions [Tenn. Code Ann. Section 67-4-2006(b)(1)] (The following is not all inclusive.)

- + Tennessee excise tax deducted on the federal tax return. (Refunds of Tennessee excise taxes are excluded from net income to the extent they have been included in federal taxable income in the year of the refund.)
- + Interest income from state and local obligations to the extent not taxable under federal law. The interest income so added back may be reduced by allowable amortization and any interest expense not deductible for federal tax purposes.
- + Gains on sales of assets not already included in the net earnings computations for federal tax purposes. (Capital gains are subject to the excise tax in the tax year incurred.)
- + Federal capital loss carrybacks or carryovers. (Capital losses may be deducted for excise tax purposes in the tax year incurred, and carryovers or carrybacks are not permitted.)
- + Percentage depletion in excess of cost depletion. (Only cost depletion is deductible for excise tax purposes.)
- + Charitable contribution carryovers. (Charitable contributions may be deducted for excise tax purposes in the tax year that they are made. Carryovers are not permitted.)
- + Non-business losses net of related expenses.
- + Any gain realized by an S corporation attributable to a IRC Section 338(h)(10) election. [Tenn. Code Ann. Section 67-4-2006(b)(1) amended by Public Chapter 602, Acts of 2007]
- + Any gain on the sale of an asset based on the asset's federal tax basis without any adjustment as a result of the taxpayer not having been subject to Tennessee excise tax during any portion of the period during which the taxpayer took depreciation on the asset for federal income tax purposes. [Tenn. Code Ann. Section 67-4-2006(b)(2)(C) amended by Public Chapter 602, Acts of 2007]

Deductions from Federal Taxable Income before the Net Operating Loss Deduction and Special Deductions [Tenn. Code Ann. Section 67-4-2006(b)(2)] (The following is not all inclusive.)

- + Dividends earned by a taxpayer that owns 80% or more of the outstanding capital stock of a corporation. (Expenses incurred in earning the dividends need not reduce this deduction.)

FRANCHISE AND EXCISE TAXES

THE EXCISE TAX (cont'd)

- + Amounts included in federal taxable income but not taxable under state law.
- + Actual charitable contributions made by the taxpayer during the tax year but not deducted for federal purposes. (Contributions may be deducted for excise tax purposes in the tax year that they are made. Carryovers are not permitted.) (Real property contributed must be valued at book value rather than fair market value.)
- + Capital losses incurred during the tax year not deducted for federal purposes. (Capital losses may be deducted for excise tax purposes in the tax year incurred. Capital loss carryovers or carrybacks are not permitted.)
- + Net operating losses carryovers. (The carryover period for losses allocable to Tennessee is 15 years for losses incurred in fiscal years ending on or after January 15, 1984. Net operating losses can be claimed only by the entity that suffered the loss. Taxpayers are not entitled to use net operating losses that occurred before they became subject to the excise tax.)
- + Non-business earnings. (Non-business earnings directly allocated to Tennessee under Tenn. Code Ann. Section 67-4-2011 are taxed in Tennessee at 100%.)
- + Effective for tax years beginning on or after July 1, 2004, 75% of the amount donated to a qualified public school support group. The school support group must be registered with the Department of Revenue for sales and use tax purposes, must spend the donated funds on goods or services subject to the sales and use tax, and must certify to the taxpayer making the donation that the sales and use tax has actually been paid. [Tenn. Code Ann. Section 67-4-2006(b)(2)(N)]
- + Effective for tax years beginning on or after July 1, 2005, 75% of the value of charitable donations made to IRC 501(c)(3) exempt nonprofit corporations, associations, and organizations; to IRC 501(c)(4) exempt nonprofit civic leagues or organizations; and to IRC 501(c)(5) and 501(c)(6) exempt associations and organizations. The receiving exempt organization must be registered with the Department of Revenue for sales and use tax purposes, must spend the donated funds on goods or services subject to the sales and use tax, and must certify to the taxpayer making the donation that the sales and use tax has actually been paid. Effective June 27, 2006, the exemption for donations made to organizations exempt under IRC 501(c)(6) is eliminated. [Tenn. Code Ann. Section 67-4-2006(b)(2)(Q)]
- + Any loss realized by an S corporation attributable to a IRC Section 338(h)(10) election. [Tenn. Code Ann. Section 67-4-2006(b)(1) amended by Public Chapter 602, Acts of 2007]
- + Any loss on the sale of an asset based on the asset's federal tax basis without any adjustment as a result of the taxpayer not having been subject to Tennessee excise tax during any portion of the period during which the taxpayer took depreciation on the asset for federal income tax purposes. [Tenn. Code Ann. Section 67-4-2006(b)(2)(C) amended by Public Chapter 602, Acts of 2007]

Permanent Decoupling from Federal Accelerated Depreciation

For tax periods ending on or after July 15, 2002, Tennessee has permanently decoupled from federal accelerated depreciation for excise tax purposes. Depreciation should be calculated using the schedules that existed immediately prior to the federal Job Creation and Worker Assistance Act of 2002. If any taxpayer for fiscal year 2003 failed to accurately calculate the proper amount of depreciation as a result of the ambiguity in the prior law and such failure lead to the underpayment of tax for fiscal year 2003, then the taxpayer has until June 30, 2004, to make additional payments without penalty and interest accruing.

The increase in the Internal Revenue Code Section 179 expense election from \$25,000 to \$100,000 will be allowed.

Returns, quarterly estimated payments, and extension payments due prior to July 1, 2004 and required to be amended as a result of this clarification must be filed by June 30, 2004 in order to avoid the accruing of penalty and interest which will begin accruing after that date. [Tenn. Code Ann. Sections 67-4-2006(b)(1)(H) and 67-4-2006(b)(2)(I)]

Tennessee has decoupled from the provisions of the 2004 American Jobs Creation Act that allows a deduction from federal taxes for a specified portion of "Qualified Production Activity Income." The new law requires that any deduction taken under 26 U.S.C. Section 199 to be added back to the taxpayer's net earnings for Tennessee excise tax purposes. [Tenn. Code Ann. Section 67-4-2006(b)(1)(M)]

FRANCHISE AND EXCISE TAXES

THE EXCISE TAX (cont'd)

Business and Non-business Earnings and Losses

For Excise Tax purposes, earnings (losses) are considered to be business earnings (losses) if they arise from activities in the regular course of the taxpayer's business (the transactional test) or from tangible or intangible personal property, the acquisition, use, management, or disposition of which constitutes an integral part of the taxpayer's business (the functional test). All earnings (losses) that are not specifically defined as business earnings (losses) are considered to be non-business earnings (losses).

The classification of earnings (losses) as business or non-business makes no difference to a taxpayer that is not doing business outside Tennessee so as to be entitled to apportion because, for such a taxpayer, both business and non-business earnings (losses) are taxed at 100% in Tennessee. However, some taxpayers are entitled to apportion their business earnings because they are doing business both within and outside Tennessee. Those taxpayers pay excise tax on their apportioned business earnings or carry forward their business losses. They then allocate their non-business earnings (losses) to either Tennessee or to another state in accordance with the provisions of Tenn. Code Ann. Section 67-4-2011.

Generally, when both the transactional and functional tests are applied, income (losses) from such items as dividends, interest, rents, royalties, capital gains, patents, and copyrights will be business income (losses) because they arise either in the regular course of the taxpayer's business or from tangible or intangible personal property, the acquisition, use, management, or disposition of which constitutes an integral part of the taxpayer's business. [Tenn. Code Ann. Sections 67-4-2004(1) and 2011]

Allocation of Non-business Earnings (Losses)

In the event that income (losses) from such items as dividends, interest, rents, royalties, capital gains, patents, and copyrights are non-business in nature, they are not included in apportionable income but are directly allocated either to Tennessee or to another state as follows:

- + Dividends and interest are allocated to Tennessee if the taxpayer is domiciled in Tennessee.
- + Rents and royalties from real property sited in Tennessee are allocable to Tennessee.
- + Rents and royalties from tangible personal property are allocable to Tennessee to the extent that the property was utilized in Tennessee or in their entirety if the taxpayer's domicile is in Tennessee and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.
- + Capital gains and losses from the sale of real property are allocated to Tennessee if the situs of the property is in Tennessee.
- + Capital gains and losses from sales of tangible personal property are allocated to Tennessee if the property had situs in Tennessee at the time of sale or the taxpayer is domiciled in Tennessee and is not taxable in the state where the property had situs.
- + Capital gains from sales of intangible property are allocable to Tennessee if the taxpayer's domicile is in Tennessee.
- + Patent and copyright royalties are allocable to Tennessee to the extent utilized by the payer in Tennessee or if utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer is domiciled in Tennessee.

Non-business income that has been directly allocated to Tennessee is 100% subject to the excise tax. [Tenn. Code Ann. Section 67-4-2011]

Disclosure Requirements for Intangible Expense Deductions

For tax periods beginning on or after January 1, 2004, taxpayers are required to disclose, on their excise tax return, any intangible expenses paid to an affiliate company. The department will use this information to examine such transactions on a case-by-case basis to determine if such expenses are allowable as deductions in determining net earnings for excise tax purposes.

Intangible expenses are expenses related to intangible property, such as patents, trademarks, and franchise rights. An affiliated company is one in which the taxpayer has more than a 50% ownership interest, one that has more than a 50% ownership interest in the taxpayer, or one in which the taxpayer's parent company has more than 50% ownership interest. [Tenn. Code Ann. Sections 67-4-2004(1), (18), (19), and (2); 67-4-2006(b)(1)(L); and 67-4-2006(b)(2)(O)]

FRANCHISE AND EXCISE TAXES

THE EXCISE TAX (cont'd)

If the taxpayer fails to make the disclosure, intangible expense items deducted will be added back to net earnings. If, as a result of adding back such undisclosed intangible expenses, a taxpayer underpays its excise tax liability, a 50% negligence penalty will be levied on the amount of underpayment. [Tenn. Code Ann. Section 67-1-804(b)(2)]

Capital Gain Realization on Distribution of Assets

Effective for asset sales occurring on or after July 1, 2004, a capital gain on the sale of an asset distributed to a nontaxable entity or individual must be recognized if the asset is not sold within

12 months of being distributed to such entity or individual. If the distributing entity liquidates prior to the asset sale, the otherwise nontaxable entity or individual is liable for the excise tax on the gain. If the entity merges into a nontaxable entity that then sells the asset, the nontaxable entity is liable for the excise tax on the sale. If the entity executes a document forfeiting its limited liability protection or its taxable status within the 12-month period immediately prior to the sale, the entity itself remains liable for the excise tax on the gain. The tax does not apply to an entity having not-for-profit status. In no case shall a gain from the same transaction be taxed twice. The new 50% penalty for failure to disclose a transaction may be applied for failure report this gain. [Tenn. Code Ann. Section 67-4-2007(f)]

FRANCHISE AND EXCISE TAXES

RETURNS AND PAYMENT

Filing the Annual Return

Each taxpayer liable for the franchise and excise tax must file an accurate and complete return, signed by its president or other principal officer, under penalty of perjury. The return will contain the taxpayer's name, the state in which chartered or organized, the location of its principal place of business in this state, and the location of its principal or home office; if applicable, the amount of capital stock subscribed and paid in, the amount issued and outstanding, the amount of surplus and undivided profits or, if applicable, the net worth together with the book value of each share of stock as shown by the records of the corporation at the close of its last fiscal year; a comparative balance sheet as of the beginning and close of the last fiscal year as shown by the records of the taxpayer; an income statement with appropriate supporting schedules; and any other information that the Commissioner may require for the reasonable enforcement of the tax. [Tenn. Code Ann. Sections 67-4-2006 and 67-4-2114(a)]

Financial institutions forming a unitary business will file a combined return and pay tax on all operations of the unitary business. Information normally required for the franchise and excise tax return will be included for every member of the unitary group even if some of the members would not otherwise be subject to the tax. Dividends, receipts, and expenses resulting from transactions between members of a unitary group shall be excluded from the return for purposes of apportionment. [Tenn. Code Ann. Sections 67-4-2006(a)(3) and 2114(c)]

For tax years beginning on or after January 1, 2004, a taxpayer that is a member of an affiliated group or a financial institution affiliated group may elect to compute its net worth on a consolidated basis provided that, upon election, each member of the consolidated group will be required to compute its worth on a consolidated basis. Such taxpayers must file a group registration form and must file on a consolidated basis for a minimum of 5 years. A Franchise and Excise Consolidated Net Worth Election Registration Application is available on the Department's web site. [Tenn. Code Ann. Section 67-4-2103(d)]

The franchise and excise tax return will be filed with the Commissioner not later than the 15th

day of the fourth month following the close of the taxpayer's tax year. The return must coincide with the accounting period covered by the federal return. The appropriate tax must be paid to the Department at the time of filing the return. [Tenn. Code Ann. Section 67-4-2015(a)]

At the Commissioner's discretion, any taxpayer may be required to file, with its franchise and excise tax return, a copy of the federal tax forms filed with the Internal Revenue Service for the same tax year. [Tenn. Code Ann. Sections 67-4-2003(b) and 2103(b)]

Estimated Tax Payments

Any taxpayer having a combined franchise and excise tax liability of \$5,000 or more for the current tax year must make 4 equal quarterly estimated franchise and excise tax payments for its current tax year. The minimum amount of each quarterly payment shall be the lesser of one fourth of the combined franchise and excise tax liability for the preceding tax year, annualized if the preceding tax year was for less than 12 months, or one fourth of 100% of the combined franchise and excise tax liability for the current tax year.

The quarterly payments will be due on the 15th day of the fourth, sixth, and ninth months of the current tax year and the first month of the next tax year. If any of the quarterly payments become deficient or delinquent, a penalty of 5% for each month of underpayment, not to exceed a total of 25%, will be assessed. Interest will also be assessed on the delinquency or deficiency. A taxpayer that has timely made 4 quarterly estimated franchise and excise tax payments, each of at least 25% of the current year's franchise and excise tax liability, will not be assessed a deficiency penalty on any quarterly payment. [Tenn. Code Ann. Section 67-4-2015]

Required Estimated Payment Information for Previous Years

For tax years beginning on or after July 1, 1999, and before July 1, 2000, the minimum quarterly payment is the greater of (a) 25% of the prior year's combined franchise and excise tax liability, or (b) 25% of 50% of the current year's combined franchise and excise tax liability. For tax years beginning before July 1, 1999, or after

FRANCHISE AND EXCISE TAXES

RETURNS AND PAYMENT (cont'd)

June 30, 2000 to May 19, 2003, the minimum quarterly payment is the lesser of (a) 25% of the prior year's combined franchise and excise tax liability, or (b) 25% of 80% of the current year's combined franchise and excise tax liability; effective May 19, 2003: 25% of 100% of the current year combined rate. [Tenn. Code Ann. Section 67-4-2015]

Extension of Filing Time

An extension of 6 months in which to file the franchise and excise tax return will be granted provided that, by the original due date of the return, the taxpayer has paid franchise and excise tax equal to 90% of the liability for the tax year for which the extension is being requested. If the amount paid is not equal to at least 90% or the return isn't filed by the extended due date, penalties and interest will be added from the original due date as though no extension had been granted. [Tenn. Code Ann. Section 67-4-2015(g)]

Penalties for Late Filing

Taxpayers failing to file, or filing late, are subject to a penalty of 5% per month, up to 25%, with a minimum penalty of \$15. In addition, interest accrues at a rate set by the Commissioner of Revenue. The \$15 minimum penalty applies even if no tax is due or if an adequate amount of tax was paid before the return was filed. [Tenn. Code Ann. Section 67-1-801]

Failure to Disclose Transactions

If the taxpayer fails to make a disclosure and underpays its tax liability, a 50% negligence penalty will be imposed on the amount of any underpayment. [Tenn. Code Ann. Section 67-1-804(b)]

Proration of Franchise Tax for Partial Year Returns

For franchise tax purposes, Tenn. Code Ann. Section 67-4-2115 has been amended to allow for prorating the franchise tax in only two instances – if the tax year is closed within less than 12 months of incorporation, domestication, or commencement of business in Tennessee, or if the taxpayer changes its accounting period covered by the federal return. No other prorating of franchise tax will be permitted. Consistent with Department of Revenue policy, Tenn. Code

Ann. Section 67-4-2015 has also been amended to state that there is no prorating of excise tax for a return that covers a period of less than 12 months. [Tenn. Code Ann. Section 67-4-2115]

Delinquent Accounts

When a taxpayer becomes 90 days delinquent in the payment of the tax, the Commissioner will certify the name of that taxpayer to the Secretary of State. At that time, following notification to the taxpayer, the taxpayer's charter or certificate to do business in Tennessee will automatically be dissolved. If the taxpayer subsequently pays all taxes, fees, interest, and penalties, the charter or certificate may be reinstated unless another taxpayer has taken title. [Tenn. Code Ann. Sections 67-4-2016 and 2116]

Return Forms

The Franchise, Excise Tax Return Form, FAE 170, along with instructions and appropriate schedules are mailed to all registered franchise and excise taxpayers by the Department of Revenue based on the ending date of the taxpayer's fiscal year. Should there be a change in the taxpayer's filing status, fiscal year dates, or a need for additional forms, the forms may be accessed on the Department of Revenue's Internet web site. The address is www.tennessee.gov/revenue. Forms may also be requested by calling the Department at one of the phone numbers listed in this publication.

Electronic Filing for Minimum Payment Returns

Electronic filing for franchise and excise tax minimum payment returns is now available through the state's web portal at <http://www.tennesseeanytime.org/fnetax/>.

FRANCHISE AND EXCISE TAXES

CREDITS

Overpayments

When an audit of a franchise and excise tax return, for any year not barred by the statute of limitations, discloses an overpayment of the amount of franchise and excise tax due, the taxpayer may apply the amount overpaid as a credit or receive a refund in the amount of the overpayment. [Tenn. Code Ann. Sections 67-4-2009(2) and 2109(d)]

Day Care Construction Tax Credit

A taxpayer may take a credit against franchise and excise taxes for 25% of the total expenditures incurred in the planning, site preparation, construction, renovation, or acquisition of facilities for the purpose of establishing a child day care center, built after April 1994, for use by the children of the taxpayer's employees. The credit allowed for any income year may not exceed \$25,000. The amount of credit allowed may be carried over and applied for up to 3 years as long as the day care center was in use for at least 6 months of each tax year. [Tenn. Code Ann. Sections 67-4-2009(3) and 2109(b)(1)]

Income Tax Credit

A taxpayer may take a credit against its excise tax for any Tennessee income tax that it pays. [Tenn. Code Ann. Section 67-4-2009(8)]

Low Income Housing Tax Credit

A taxpayer may take a credit against the combined franchise and excise tax liability for unbudgeted property taxes paid in association with the low-income housing tax credit program. This credit will exist for 5 years and will expire after the fifth year in which it is claimed. [Tenn. Code Ann. Sections 67-4-2009(9) and 2109(f)]

Industrial Machinery Tax Credit

A credit equal to 1% of the cost of industrial machinery purchased or leased during the tax year and located in Tennessee may be taken against both the franchise and excise tax liability. The credit and any carryover thereof may not exceed 50% of the combined franchise and excise tax liability for the year in which it is taken and may be carried over for no more than 15 years. If any industrial machinery purchased

is removed from the state, sold, or otherwise disposed of during its useful life, the state may recover a portion of the credit given. If industrial machinery is leased for less than 80% of its useful life, the amount of the credit will be determined by multiplying the purchase price by the percent of the useful life for which the machinery is leased.

However, a taxpayer that has established its international, national, or regional headquarters in Tennessee, or a taxpayer that has established an international, national, or regional warehousing or distribution hub in Tennessee, may be permitted to offset up to 100 percent of its combined franchise and excise tax liability. The increased amount of credit available for offset must be determined by the commissioner of revenue and the commissioner of economic and community development to be in the best interests of the state.

Effective June 28, 2007, the industrial machinery exemption credit for a taxpayer that has established its international, national, or regional headquarters in Tennessee, or a taxpayer that has established an international, national, or regional warehousing or distribution hub in Tennessee was revised to offer tiered levels of credit based on the level of Tennessee investment during the investment period.

If the taxpayer makes a required capital investment in excess of \$1 billion during the investment period, the credit allowed equals 10% of the purchase price of industrial machinery located in Tennessee and purchases in the process of making the required capital investment.

If the taxpayer makes a required capital investment in excess of \$500 million, the credit allowed equals 7%. If the taxpayer makes a required capital investment in excess of \$250 million, the credit allowed equals 5%. If the taxpayer makes a required capital investment in excess of \$100 million, the credit allowed equals 3%.

The investment period during which the required capital investment must be made cannot exceed 3 years from the filing of the business plan related to the required capital investment. The 3-year period may be extended by the Commissioner of

FRANCHISE AND EXCISE TAXES

CREDITS (cont'd)

Economic Development for a reasonable period, not to exceed 2 years, for good cause shown. [Tenn. Code Ann. Section 67-4-2009 as amended by Public Chapter 602, Acts of 2007]

Hospital Company Tax Credit

A hospital company filing a franchise and excise tax return on a combined basis with other members of its controlled group may take a credit of the lesser of the franchise or excise amounts due. This credit will not be available for tax years beginning on or after January 1, 2007. The group may also take a credit on the remaining tax of 4% of the cost of medical supplies or equipment placed into use in the state during the tax year. The amount of the total credit may not exceed \$9 million in any tax year and will not be available for tax years beginning on or after January 1, 2007. To be eligible for this credit, the hospital company had to qualify with the Department of Revenue before January 1, 1999. [Tenn. Code Ann. Sections 67-4-2009(5) and 2009(6)]

Job Tax Credit

A job tax credit of \$2,000 for each net new full-time employee job will be allowed against a taxpayer's franchise tax liability for any year provided that:

- + The job is a newly created position in Tennessee and did not exist as a position in any business for at least 90 days prior to being filled by the taxpayer.
- + The job was filled during the tax year and was in existence at the end of the tax year.
- + The taxpayer has met the required capital investment of \$500,000 in the qualified business enterprise.
- + The credit will first be available in the tax year in which the qualified business enterprise increases net new full-time employment by 25 or more jobs and in those subsequent tax years in which further net job increases occur above the level of employment established when the credit was last taken.
- + The new full-time employee jobs are filled prior to January 1, 2008.

For businesses engaged in convention or trade show enterprises, the minimum required capital investment is \$10 million.

A tiered jobs tax credit is available for counties determined to be economically distressed by the

Department of Economic and Community Development or federally designated empowerment zones. Economically distressed counties will be designated as tier one, tier two, or tier three, based on unemployment, per capita income, and poverty levels. A list of counties designated by tiers will be published annually.

A qualified business enterprise located in a tier one, tier two, or tier three economically distressed county or federally designated empowerment zone will receive a \$4,500 for each net new full-time job.

A qualified business enterprise located in a tier two county will receive an additional annual credit of \$4,500 for each net new full-time employee job, and the annual credit will be allowed for a period of 3 years, beginning with the first tax year after the initial jobs tax credit is created.

A qualified business enterprise located in a tier three county will receive an additional annual credit of \$4,500 for each net new full-time employee job, and the annual credit will be allowed for a period of 5 years, beginning with the first tax year after the initial jobs tax credit is created.

The annual credit may be used to offset up to 100% of the franchise and excise tax liability, but it may not be carried forward beyond the year in which the credit originated. [Tenn. Code Ann. Section 67-4-2109(c) amended by Public Chapter 602, Acts of 2007]

If the business enterprise is located in an economically distressed county and promotes high-skill, high-wage jobs in high-technology areas, emerging occupations or skilled manufacturing jobs, then the credit shall apply in the tax year when net new full-time employment increases by one (1) or more jobs.

A qualified business enterprise located in a federally designated empowerment zone must invest a minimum of \$20 million and create a minimum of 1,000 jobs to qualify for the higher tax credit. [Tenn. Code Ann. Section 67-4-2109]

Taxpayers wishing to qualify for this credit will file a business plan with the Commissioner of

FRANCHISE AND EXCISE TAXES

CREDITS (cont'd)

Revenue. The business plan must be filed on or before the last day of the fiscal year in which the investment is made and must describe the investment made, the number of jobs the investment will create, and the expected dates the jobs will be filled.

Any unused job tax credit, incurred for a tax year beginning prior to July 1, 1999, may be carried forward for 15 years after the fiscal year in which the credit originated subject to limitations established by prior law. Any unused job tax credit, incurred for a tax year beginning on or after July 1, 1999, may be carried forward for 15 years after the tax year in which the credit originated. For job tax credits incurred in tax years beginning on or after July 1, 1999, the amount of the credit or any amount carried forward will be limited as follows:

<u>Number of Full-Time Employees at FY End</u>	<u>% of F, E Tax Liability Offset by Tax Credit</u>
Less than 1,000	33 1/3%
1,000 but less than 3,000	50%
3,000 but less than 5,000	75%
5,000 or more	100%

A business enterprise involving a required capital investment in excess of \$1 billion, invested over not more than 3 years from the date of filing the first business plan relating to the business enterprise, and creating at least 1,000 full-time employee jobs with “top out” wages at least equal to 150% of Tennessee’s average industrial wage for all manufacturing sectors, will be allowed a credit of \$5,000 for each net new full-time job created.

“Top out wage” means the wage that an employer assigns to a given job and will be obtained after a worker has completed all required training and experience in that job over an initial period not to exceed 3 years.

In addition to the \$5000 tax credits allowed for the first tax year, all or a portion of the tax credits allowed may also apply on an annual basis to offset the taxpayer’s franchise and excise tax liability for each tax year after the first tax year for up to 20 years. The full-time employee jobs created by the required capital investment for which credits were originally issued must

remain filled by employees at wages equal to or greater than 150% of Tennessee’s average industrial wage for all manufacturing sectors. The Commissioner of Economic and Community Development, with the written concurrence of the Comptroller of the treasury, must determine that the location and nature of the capital investment is economically desirable and in the best interests of the citizens of this state, and must specify, for each business enterprise, the maximum period the additional tax credits granted will be allowed and the amount of additional tax credits that will be allowed each year after the first tax year during the specified maximum period.

The required capital investment will be considered made on the date of payment or the date the business enterprise enters into a legally binding commitment for purchase or construction. The Commissioner of Economic and Community Development may, for good cause, extend the 3-year period for making the required capital investment and the 3-year period after a worker’s completion of initial training or probationary period for up to 2 years. [Tenn. Code Ann. Section 67-4-2109(c)(2)(G)]

Effective for tax periods beginning on or after January 1, 2006, the job tax credit is modified by establishing tiered criteria and benefits.

For purposes of the new jobs tax credits described below, the following definitions apply:

“Investment period” means a period not in excess of three years from the filing of the related business plan during which the required capital investment must be made.

An “industrial wage job” is a full-time employee job with wages equal to or greater than Tennessee’s “average industrial wage” for the month of January of the year during which the job was created.

“Average industrial wage” means the average industrial wage for all manufacturing sectors as reported in the Monthly Labor Report published by the Tennessee Department of Labor and Workforce Development.

A taxpayer that makes a capital investment in excess of \$500 million and that creates at least 500 new net industrial wage jobs during the

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CREDITS (cont'd)

investment period is allowed a credit of \$5,000 for each industrial wage job created during the investment period.

In addition to the job tax credit described above, an additional annual tax credit of \$5,000 for each new net industrial wage job created during the investment period may be used to offset up to 100% of the taxpayer's franchise and excise tax liability for a period of 12 years beginning the first year after the investment and job threshold criteria are met, provided that the jobs remain filled by employees at wages equal to or greater than Tennessee's average industrial wage for the month of January of the year in which the credit is taken. However, any unused credit cannot be carried forward beyond the year in which the credit originated.

A taxpayer that makes a capital investment in excess of \$250 million and that creates at least 250 new net industrial wage jobs during the investment period is allowed a credit of \$5,000 for each industrial wage job created during the investment period.

In addition to the job tax credit described above, an additional annual tax credit of \$5,000 for each new net industrial wage job created during the investment period may be used to offset up to 100% of the taxpayer's franchise and excise tax liability for a period of six years beginning the first year after the investment and job threshold criteria are met, provided that the jobs remain filled by employees at wages equal to or greater than Tennessee's average industrial wage for the month of January of the year in which the credit is taken. However, any unused credit cannot be carried forward beyond the year in which the credit originated.

A taxpayer that makes a capital investment in excess of \$100 million and that creates at least 100 new net industrial wage jobs during the investment period is allowed a credit of \$5,000 for each industrial wage job created during the investment period.

In addition to the job tax credit described above, an additional annual tax credit of \$5,000 for each new net industrial wage job created during the investment period may be used to offset up to 100% of the taxpayer's franchise and excise tax

liability for a period of three years beginning the first year after the investment and job threshold criteria are met, provided that the jobs remain filled by employees at wages equal to or greater than Tennessee's average industrial wage for the month of January of the year in which the credit is taken. However, any unused credit cannot be carried forward beyond the year in which the credit originated. [Tenn. Code Ann. Section 67-4-2109(c)(2)(I)]

The jobs tax credit is also allowed for new high-skill, high-wage full time employee jobs in specified areas even if net employment is not increased; however this applies only to new jobs created by a taxpayer that fails to meet the net increase requirement due to worker layoffs or reductions where workers have been certified as having been adversely affected by foreign trade and eligible for assistance under the United States Trade Adjustment Assistance Reform Act of 2002. The taxpayer must meet all other requirements for the job tax credit and provide evidence of the US Department of Labor's Division of Trade Adjustment Assistance certification of eligibility for assistance for the taxpayer's adversely affected worker group. [Tenn. Code Ann. Section 67-4-2109(c)(2)(J)]

Effective for tax periods ending on or after December 31, 2006, the 15-year limitation on the carryforward of net operating losses for a taxpayer that qualifies for the job tax credit in connection with a capital investment in excess of \$1 billion has been removed. The removal of the limitation is permitted only if it is determined by the Commissioner of Revenue and the Commissioner of Economic and Community Development to be in the best interests of the state. [Tenn. Code Ann. Section 67-4-2006(c)]

Effective June 28, 2007, there is also available a jobs tax credit for a qualified business enterprise that makes a required capital investment of at least \$10 million and creates at least 100 new full-time headquarters staff employee jobs that pay at least 150% of Tennessee's average occupational wage. The credit allowed is \$5,000 for each net new full-time headquarters staff employee job created during the investment period. An additional credit is allowed on an annual basis for a period of 3 years, beginning with the first tax year after the investment and job threshold criteria are met.

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CREDITS (cont'd)

The additional credit equals \$5,000 for each job created during the investment period, provided the jobs remain filled by employees at wages equal to at least 150% of Tennessee's average occupational wage for the month of January in the year in which the credit is being taken. This annual credit may be used to offset up to 100% of the taxpayer's franchise and excise tax liability for that year, but any unused amount of credit cannot be carried forward beyond the year in which the credit originated. [Tenn. Code Ann. Section 67-4-2109(c)(2)(l) as amended by Public Chapter 602, Acts of 2007]

Jobs Tax Credit for Employing Persons with Disabilities

Effective for tax years ending on or after July 1, 2006 a jobs tax credit of \$5,000 for each net new full-time employee job and a credit of \$2,000 for each net new part-time employee job is available for employment of persons with disabilities who are receiving Tennessee state services directly related to the disabilities.

Employment of the disabled employee must create a net increase in the number of persons with disabilities employed by the taxpayer within the 90-day period immediately preceding the employment. The taxpayer must provide the qualifying employment for at least 12 consecutive months for no less than the minimal hours per week as described in the enacting legislation for respective full-time and part-time employment jobs. The taxpayer is not required to make a capital investment in a qualified business enterprise to receive this credit.

The credit for new net employee jobs for persons with disabilities applies initially in the tax year in which the taxpayer increases net new employment of such persons by 1 or more and in subsequent fiscal years in which additional net increases occur above the level of employment established when the credit was last taken.

The taxpayer must file a plan with the Commissioner of Revenue on or before the last day of the fiscal year in which the employment begins and must state the number of persons with disabilities newly employed. [Tenn. Code Ann. Section 67-4-2109(g)]

Qualified Headquarters Relocation Expense

There is a credit for qualified headquarters relocation expenses incurred during the investment period for establishing a qualified headquarters facility provided that the taxpayer establishes and is eligible for the qualified headquarters credit and can qualify for the job tax credit in connection with a required capital investment in excess of \$1 billion.

Effective June 28, 2007, the relocation credit becomes a tiered level credit based on the level of jobs created. The credit is equal to any qualified headquarters relocation expenses incurred by the taxpayer during the investment period for establishing a qualified headquarters facility, but is limited to a specific dollar amount (based on the number of jobs created) multiplied by the number of headquarters staff employee positions relocated by the taxpayer.

- + If the taxpayer creates at least 100 but less than 250 net new full-time employee jobs that pay at least 150% of Tennessee's average occupational wage, the credit available is \$10,000 per job.
- + If the taxpayer creates at least 250 but less than 500 net new full-time employee jobs that pay at least 150% of Tennessee's average occupational wage, the credit available is \$20,000 per job.
- + If the taxpayer creates at least 500 but less than 750 net new full-time employee jobs that pay at least 150% of Tennessee's average occupational wage, the credit available is \$30,000 per job.
- + If the taxpayer creates at least 750 net new full-time employee jobs that pay at least 150% of Tennessee's average occupational wage, the credit available is \$40,000 per job.
- + If the taxpayer qualifies for the job tax credit provided in Tenn. Code Ann. Section 67-4-2109(c)(2)(h) in connection with a required capital investment of \$1 billion, the relocation credit will equal \$50,000 per job.

Any amount allowed as a credit that exceeds the taxpayer's liability will be refunded to the taxpayer as an overpayment. [Tenn. Code Ann. Section 67-4-2109(h) amended by Public Chapter 602, Acts of 2007]

If the qualified headquarters facility is not utilized as a headquarters facility for at least 10 years from the beginning date of substantial completion of the headquarters, or if a headquarters staff position does not remain filled for 5 years from the date the position was

FRANCHISE AND EXCISE TAXES

CREDITS (cont'd)

relocated to Tennessee, the taxpayer will be assessed for repayment of the credit taken. The taxpayer is not required to establish its commercial domicile in Tennessee to receive this credit. [Tenn. Code Ann. Section 67-4-2109(g)]

A taxpayer that has established its international, national or regional headquarters in Tennessee, or a taxpayer that has established an international, national or regional warehousing or distribution hub in Tennessee, to offset up to 100 percent of its franchise and/or excise tax liability by its job tax credits earned and not expended as of June 1, 2006, or by any carry forward of such credits. The increased amount of credit available for offset must be determined by the Commissioner of Revenue and the Commissioner of Economic and Community Development to be in the best interests of the state. [Tenn. Code Ann. Section 67-4-2109(c)(2)(G)]

Effective June 27, 2006, a taxpayer that has established its international, national, or regional headquarters in Tennessee, or a taxpayer that has established an international, national, or regional warehousing or distribution hub in Tennessee, is allowed to convert unused net operating losses to a credit against its franchise tax liability. The credit is available only if the taxpayer is unable to use the net operating loss or loss carryover to offset net income during the current tax year. If a net operating loss is converted to a credit against the franchise tax, it is no longer available as a deduction for excise tax purposes. The credit is available only if it is determined by the Commissioner of Revenue and the Commissioner of Economic and Community Development to be in the best interests of the state. [Tenn. Code Ann. Section 67-4-2109]

Effective for tax periods beginning on or after January 1, 2006, if the headquarters staff employee position does not remain filled in Tennessee for a period of at least five years, beginning from the date such employee position was initially filled in Tennessee, the taxpayer shall be subject to an assessment of the total amount of credit or refund taken relating to such employee position, plus interest. [Public Chapter 1019, Acts of 2006]

Qualified Production Company Refund

Effective for tax periods ending on or after December 31, 2006, a qualified production company that incurs at least \$1 million in qualified expenses is entitled to a refund equal to 15% of its qualified expenses, provided that the company has established a headquarters facility in Tennessee. If the qualified production company does not have a headquarters facility in Tennessee, then any qualified investor that has a headquarters facility in Tennessee is allowed a refund equal to the amount to which the qualified

production company would have been entitled, multiplied by the qualified investor's percentage ownership in the company. "Qualified expenses" are expenses incurred in Tennessee that are determined to be necessary for the production of a movie in Tennessee. [Tenn. Code Ann. Section 67-4-2109]

Financial Institution Loans to Eligible Housing Entities

Effective for tax years ending on or after July 1, 2005, a financial institution is allowed a credit against the franchise and excise taxes equal to 5% of a qualified loan or long time investment or equal to 10% of a grant, contribution, or qualified low-rate loan made to any Tennessee nonprofit corporation with an IRC Section 501(c)(3) status, the Tennessee Housing Development agency, a public housing authority, or a development district for any eligible activity.

"Eligible activity" is defined as an activity that creates or preserves affordable housing for low-income Tennesseans, an activity to help low-income Tennesseans obtain safe and affordable housing, an activity which builds the capacity of an eligible nonprofit to provide housing opportunities to low income Tennesseans, and any other activities approved by the executive director of the Tennessee Housing Development Agency and the Commissioner of Revenue.

In order to take the credit, the regulated financial institution must maintain a certification from the Tennessee Housing Development Agency establishing credit entitlement and such records as required by the Tennessee Housing Development Agency to ensure that affordable housing opportunities are being provided. Any

FRANCHISE AND EXCISE TAXES

CREDITS (cont'd)

unused credit can be carried forward for 15 years from the year in which the credit originated.

Effective June 27, 2006, the franchise and excise tax credit available to financial institutions for low-rate loans made to non-profit entities that provide affordable housing or to community development financial institutions may be calculated based either on 5 percent of the original amount of the loan or 3 percent of the unpaid balance at the end of each year for 15 years. [Tenn. Code Ann. Section 67-4-2109]

Call Center Credits

The job tax and industrial machinery tax credits may be computed by a general partnership that operates a call center in Tennessee that is placed into operation on or after June 30, 2003, and would otherwise qualify for the credits under the law. With respect to the general partnership tax year in which the credit is computed, any partner that holds a first tier ownership in the general partnership, and is subject to the franchise and excise tax, may take a percentage of the credit against that partner's franchise and excise tax liability that equals the total amount of the general partnership's credit multiplied by the partner's percentage interest in the general partnership on the last day of the general partnership's tax year. The credits, in the hands of the first tier partner, are subject to all applicable provisions and limitations provided under the franchise and excise tax law.

In no case will a credit or carryover thereof be taken by a business entity unless that entity was a partner in the general partnership and subject to the franchise and excise tax at the time the credit was earned by the general partnership. [Tenn. Code Ann. Sections 67-4-2009(4)(H) and 67-4-2109(c)(3)]

Tennessee Rural Opportunity Fund Credit

Effective June 28, 2007, a credit is available in an amount equal to 10% of a financial institution's contribution to the Tennessee Rural Opportunity Fund. The credit is allowed each year for a period of 10 years, beginning with the tax year in which the contribution is made. Any

unused credit cannot be carried forward beyond the year in which the credit originated.

Loaning funds to the Tennessee Rural Opportunity Fund by the taxpayer will constitute a contribution. However, if at the close of the tenth year of the period during which the credit is allowed, the taxpayer or its assignee received repayment, or retains any right to payment, of all or any portion of the amount contributed or any interest accrued on the amount contributed, the credit plus interest will be recaptured in the first tax year following the ten-year period during which the credit is allowed. [Tenn. Code Ann. Section 67-4-2109 amended by Public Chapter 602, Acts of 2007]

Eligibility under Previous Law

Taxpayers not subject to the franchise and excise taxes in 1997 and 1998, and who meet the criteria set forth below, may compute the job tax credit they would have qualified for in 1997 and 1998 under the previous franchise and excise tax law, compute the amount of the credit they would have taken on their returns for 1997 and 1998, and the amount they would have carried forward to subsequent years in which they were not subject to the tax. Any excess credit then may be carried forward to tax years in which they were subject to the tax. The criteria these taxpayers must meet are:

- + They were formed as business entities after December 31, 1995.
- + They were not subject to the Tennessee franchise and excise tax prior to Chapter 406 of the Public Acts of 1999.
- + They could have qualified for the job tax credit, under the previous franchise and excise tax law repealed by Chapter 406, in the years 1997 and 1998, had they been subject to the provisions of the previous law.

The excess job tax credit may be carried forward for a period of 15 years from the tax year in which it originated.

These same entities may compute the amount, if any, of the industrial machinery credit and the net operating loss carryover they would have been eligible for in tax years 1997 and 1998 and the amounts they would have applied in those tax years. Any excesses may be carried forward in the same manner as the excess job tax credit. [Tenn. Code Ann. Section 67-4-2018]

FRANCHISE AND EXCISE TAXES

APPORTIONMENT TO TENNESSEE

Apportionment by Multi-state Corporations

[Tenn. Code Ann. Sections 67-4-2010, 2011, 2012]
[Franchise and Excise Tax Rule 1320-6-1-.25]

A taxpayer doing business in Tennessee, and also doing business outside Tennessee so as to be subject to the taxation of another state, may apportion its net worth for Tennessee franchise tax purposes and net earnings for Tennessee excise tax purposes. This is done by multiplying net worth and net earnings by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the receipts factor and the denominator is the number 4.

The Property Factor

In computing the property factor, all property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at 8 times the net annual rental rate. The total used for the formula is the average of the total value of property owned or used at the beginning of the year and at the end of the year. Taxpayers having interests in general partnerships must include their proportional share of the partnership's real and tangible personal property in the formula. [Tenn. Code Ann. Sections 67-4-2012(b) and 2111(b)]

The value of owned or leased movable property, located both within and outside Tennessee during a tax period, will be determined on the basis of the total percentage of time this property is in the state during the tax period. The value of an automobile or truck assigned to a traveling employee will be considered in Tennessee if the employee's compensation is assigned to Tennessee for purposes of the taxpayer's apportionment formula payroll factor or if the vehicle is licensed in Tennessee. [Tenn. Code Ann. Sections 67-4-2012(b)-(d) and 2111 (b)-(d)]

The Payroll Factor

The payroll factor includes wages, salaries, commissions, and any other compensation for personal services of employees. A taxpayer's ownership share of the compensation paid by an entity treated as a general partnership for federal income tax purposes must be included in the payroll factor. Compensation is included in the

numerator of the factor if it is paid to an individual whose service is performed entirely in Tennessee or when only an incidental part of the employee's service is performed outside Tennessee. Compensation is also included in the numerator of the factor if some of the employee's service is performed in Tennessee and the employee has a Tennessee base of operations or, if there is no base of operations, the employee is directed or controlled from Tennessee. If an employee lives in Tennessee and the base of operations or place from which the service is directed is not in a state where some of the service is performed, then the compensation is included in the numerator of the factor. [Tenn. Code Ann. Sections 67-4-2012(e), 2111(e), and 2111(f)]

The Receipts Factor

Tennessee is a destination sales state for purposes of the apportionment formula receipts factor. Generally, sales of tangible personal property are considered to be Tennessee sales or sales outside Tennessee depending on the location of the purchaser regardless of the FOB point or other conditions of sale. Sales to the U.S. Government are Tennessee sales if the merchandise is shipped from Tennessee. Sales of other than tangible personal property are allocable to Tennessee if a greater proportion of the earnings-producing activities are performed in Tennessee. A taxpayer's ownership share of the receipts of an entity treated as a general partnership for federal income tax purposes must be included in the receipts factor. [Tenn. Code Ann. Sections 67-4-2012(g)-(i) and 2111(g)-(i)]

Any person doing business in Tennessee, who licenses the use of patents, trademarks, trade names, copyrights, know-how, or other intellectual property to another person in Tennessee, and who is paid royalties or other income based on the sale of products or other activity in Tennessee by the licensee, shall source such income to Tennessee for purposes of its apportionment formula receipts factor. Non-business receipts are not considered in the receipts factor. [Tenn. Code Ann. Sections 67-4-2012(j) and 2111(j)]

FRANCHISE AND EXCISE TAXES

APPORTIONMENT TO TENNESSEE (cont'd)

Business and Non-business Earnings (Losses)

For franchise and excise tax purposes, allocation applies only to business earnings (losses). Non-business earnings are not included in the apportionment formula. Earnings (losses) are considered to be business earnings (losses) if they arise from activities in the regular course of the taxpayer's business or from tangible or intangible personal property, the acquisition, use, management, or disposition of which constitutes an integral part of the taxpayer's business.

Variances from the Standard Apportionment Formula

In some instances, the statutory tax computation, allocation, or apportionment provisions may not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer's net worth, or the taxpayer's net earnings. In such a case, the taxpayer may petition for, or the Department may require, separate accounting; the exclusion or addition of 1 or more apportionment formula factors, or the use of other methods to determine receipts for purposes of the apportionment formula. The taxpayer may also petition for, or the Department may require, the use of any other tax computation method necessary to fairly reflect the extent of the taxpayer's activities that are subject to the Tennessee franchise and excise tax. [Tenn. Code Ann. Sections 67-4-2014 and 2112]

When 2 or more business entities (whether incorporated or affiliated or not) are, directly or indirectly, owned or controlled by the same interests, the commissioner, using appropriate federal guidelines, may make the appropriate adjustments to distribute, apportion, or allocate income, deductions, credits, allowances, or net worth among such business entities if necessary to prevent evasion of taxes, excessive use or abuse of exemptions, or to clearly reflect the income or net worth of such business entities. The commissioner may also require combined reports utilizing a common apportionment formula covering members of an affiliated group of corporations. [Tenn. Code Ann. Sections 67-4-2014(c)(1), 2014(c)(2), 2112(c)(1), and 2112(c)(2)]

The Commissioner may disregard any entity created or transaction made that has no business purpose or is created or made with the primary purpose of evading either the federal income tax or the franchise and excise tax. [Tenn. Code Ann. Section 67-4-2014(c)(4) and 2112(c)(4)]

Once another method of tax computation or apportionment has been established, it will remain in effect as long as the circumstances justifying the variation remain substantially unchanged, or until changed or discontinued by the Department, whichever occurs first. Should the Department change or discontinue a variation that has been granted to, or required of, a taxpayer, the taxpayer will be given reasonable notice. The change or discontinuation will then apply to the first, and subsequent, tax periods that begin on or after the date of the notice. [Tenn. Code Ann. Sections 67-4-2014(d) and 2112(d)]

For tax years beginning on or before December 31, 2006, a hospital company must file its franchise and excise tax return on a combined basis with all other corporations or entities subject to these taxes that are members of its controlled group and are doing business subject to taxation in Tennessee. One member of the combined group must sign these returns on behalf of all members. The combined return shall contain all financial statements and schedules that would be required of each member filing a separate franchise and excise tax return.

Each member's net earnings or losses subject to carryover, if applicable, and each member's apportionment ratio, and applicable supporting schedules must be computed separately as would be required by law if no combined return were required. The franchise and excise tax shall be computed for the combined group based on the combined net earnings or net losses of the members. The losses available to each member of the controlled group under current or prior law will be available for offset against the net earnings of the combined group in the first year of filing on a combined basis. Any portion that is not used to offset net earnings of the combined group in the first year may be carried forward, for no more than 15 years, on a combined basis to be available as an offset to future net earnings of the combined group. No member of the

FRANCHISE AND EXCISE TAXES

APPORTIONMENT TO TENNESSEE (cont'd)

combined group may file its franchise and excise tax return on a separate basis without the consent of the commissioner.

Apportionment of Net Worth of Common Carriers and Insurance Companies

When a taxpayer's principal business in Tennessee is that of common carrier or insurance company, the following ratios will be used to apportion the taxpayer's net earnings and net worth to Tennessee. For the tax year beginning on or after December 15, 2002, and all subsequent years, the franchise and excise tax is no longer applicable to insurance companies that are subject to payment of the gross premiums tax.

Railroads. The ratio obtained by taking the arithmetical average of the following ratios: (A) the gross receipts from railway business operations beginning and ending entirely within this state as compared with its gross receipts from such operations within and without the state; and (B) the mileage owned and operated within Tennessee plus mileage leased and operated within Tennessee as compared with the total of such mileage within and outside this state. [Tenn. Code Ann. Sections 67-4-2013(a)(1) and 2113(a)(1)]

Motor Carriers. The ratio obtained by taking the arithmetical average of the following ratios: (A) the gross receipts from business operations beginning and ending entirely within this state as compared with its entire gross receipts from such operations within and without Tennessee; and (B) the ratio of the total franchise miles, or odometer miles if there are no franchise miles, which it holds or uses under lease, contract, or certificate of convenience and necessity from the Interstate Commerce Commission or the Department of Safety within Tennessee, to the total franchise or odometer miles which it holds or uses, inside or outside Tennessee, under such certificates from this or other states, as shown by the annual reports made by the corporation to the various commissions from which it holds

certificates. [Tenn. Code Ann. Sections 67-4-2013(a)(2) and 2113(a)(2)]

Rail and Motor Carriers. When the taxpayer is engaged in transporting passengers and property by both rail and motor, then the apportionment ratio is the sum of the miles within Tennessee as computed under both the formula for railroads and the formula for motor carriers compared to the sum of the miles under such formulas within and without the state. [Tenn. Code Ann. Sections 67-4-2013(a)(3) and 2113(a)(3)]

Pipelines. The ratio obtained by taking the arithmetical average of the following ratios: (A) the gross receipts from operations on business beginning and ending entirely within Tennessee as compared with its entire gross receipts from such operations within and without Tennessee; and (B) the ratio of the pipeline miles owned and/or operated within Tennessee, to the miles of pipelines owned and/or operated within and without Tennessee. [Tenn. Code Ann. Sections 67-4-2013(a)(4) and 2113(a)(4)]

Insurance Companies. (For tax years beginning prior to December 15, 2002.)

(A) Domiciled in Tennessee: The ratio of the premiums on policies, persons and property in Tennessee to total such premiums everywhere; (B) Not domiciled in Tennessee: The ratio of premiums on policies, persons and property in Tennessee to the total of such premiums everywhere except that no annuity considerations will be considered a premium for this purpose. [Tenn. Code Ann. Sections 67-4-2014(c) and 2114(5)]

Air Carriers. The ratio obtained by taking the arithmetical average of the following ratios: (A) the originating revenue within Tennessee as compared with the entire originating revenue within and without Tennessee; and (B) the ratio of the total air miles flown within Tennessee to the total air miles flown within and without Tennessee. Air miles flown within Tennessee shall only include miles in Tennessee from flights originating from or ending in Tennessee, or both originating from and ending in Tennessee. [Tenn. Code Ann. Sections 67-4-2013(a)(5) and 2113(6)]

FRANCHISE AND EXCISE TAXES

APPORTIONMENT TO TENNESSEE (cont'd)

Air Express Carriers. The ratio obtained by taking the arithmetical average of the following ratios: (A) the originating revenue within Tennessee as compared with the entire originating revenue within and without Tennessee; and (B) the ratio of the total air miles flown and ground miles traveled within Tennessee to the total air miles flown and ground miles traveled within and without Tennessee. Air miles flown within Tennessee only includes miles in Tennessee from flights originating from, or ending in, Tennessee, or both originating from and ending in Tennessee. Ground miles traveled within Tennessee or traveled within and without Tennessee shall only include miles traveled with respect to the actual common carriage of persons or property for hire. [Tenn. Code Ann. Sections 67-4-20013(a)(6) and 2113(7)]

Barges. The ratio obtained by taking the arithmetical average of the following ratios: (A) the revenue from the transportation of cargo loaded in Tennessee as compared with the entire revenue from the transportation of cargo loaded inside and outside Tennessee, and (B) the ratio of the total miles operated inside Tennessee to the total miles operated inside and outside Tennessee. Miles operated in Tennessee shall be 50% of the miles operated on the Mississippi River adjacent to the Tennessee shoreline, plus all miles operated on inland waterways in Tennessee. "Miles operated" means one mile of movement of each barge. [Tenn. Code Ann. Sections 67-4-20013(a) and 2113, amended by Public Chapter 602, Acts of 2007]

Apportionment of Financial Institutions

For excise tax purposes, a financial institution not filing a combined return, that has business activities both within and outside Tennessee so as to be entitled to apportion, computes its apportionment ratio using total receipts attributable to the transaction of business in all taxing jurisdictions. A unitary group of financial institutions computes its apportionment ratio in the same manner using the combined receipts of the group with receipts from transactions between group members eliminated. The ratio so computed is then applied to the financial institution's net earnings or combined net earnings in the case of a unitary group filing on a

combined basis. [Tenn. Code Ann. Section 67-4-2013(b)]

For franchise tax purposes, a financial institution, not filing a combined return, that has business activities both within and without Tennessee so as to be entitled to apportion, computes its apportionment ratio using total receipts attributable to the transaction of business in Tennessee divided by total receipts attributable to the transaction of business in all taxing jurisdictions. The ratio so computed is then applied to the financial institution's net worth to obtain the franchise tax base.

A unitary group of financial institutions computes its apportionment ratio in the same manner for each business entity in the group. In the case of a financial institution not filing a combined return, the ratio so computed is then applied to the financial institution's net worth. Each member of a unitary group of financial institutions filing a combined return applies its own apportionment ratio to its own net worth, and the results are then combined to obtain the net worth franchise tax base for the unitary group. [Tenn. Code Ann. Sections 67-4-2118(a) and 2118(b)]

For the purpose of computing the apportionment ratios of financial institutions, receipts includes net taxable gain on disposition of assets such as securities and money market transactions, when derived from transactions and activities in the regular course of business. Gross receipts of a financial institution and the basis on which they will be attributed to Tennessee are as follows:

- + Receipts from the lease or rental of real or tangible personal property located in Tennessee.
- + Interest income and other receipts from assets in the nature of loans or installment sales contracts that are primarily secured by or deal with real or tangible personal property located in Tennessee. If any part of the sale property or property standing as security for the payment of the debt is located part within and part outside the state, only such proportion of the interest income or other receipts shall be attributed to Tennessee as the value of the property within the state bears to the whole property.
- + Interest income and other receipts from consumer loans, not secured by real or tangible personal property, made by any means to a resident of Tennessee.

FRANCHISE AND EXCISE TAXES

APPORTIONMENT TO TENNESSEE

(cont'd)

- + Interest income and other receipts from commercial loans and installment obligations, not secured by real or tangible personal property, to be applied in Tennessee. If it cannot be determined where the funds are to be applied, the receipts are to be attributed to the state in which the business applied for the loan. The term "loan" does not include demand deposit accounts, federal funds, certificates of deposit, and other similar wholesale banking instruments issued by other financial institutions.
- + All receipts and fee income from the issuance of letters of credit, acceptance of drafts, and other devices for assuring or guaranteeing a loan or credit shall be attributed in the same manner as interest income and other receipts from the loan are attributed.
- + Interest income, merchant discount, other receipts (including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders), and fees shall be attributed to the state to which the card charges and fees are regularly billed.
- + Receipts from the sale of tangible or intangible assets will be attributed in the same manner that the income from the asset would be attributed.
- + Receipts from the performance of fiduciary and other services shall be attributed in accordance with the apportionment formula for persons doing business both within and outside the state.

- + Receipts from the issuance of traveler's checks, money orders, or United States savings bonds shall be attributed to the state where such items are purchased.
- + Receipts from a participating financial institution's portion of participation loans shall be attributed as otherwise provided. A participation loan is any loan in which more than one lender is a creditor to a common borrower. [Tenn. Code Ann. Sections 67-4-2013(b) and 2118]

For tax periods beginning on or after January 1, 2006, a taxpayer may apportion its net earnings or net losses and its net worth if it has business activities that are taxable both inside and outside Tennessee. A taxpayer is considered taxable in another state only if the taxpayer is conducting activities in that state that, if conducted in Tennessee, would constitute doing business in Tennessee and would subject the taxpayer to the franchise or excise tax. [Tenn. Code Ann. Sections 67-4-2010 and 67-4-2110]

FRANCHISE AND EXCISE TAXES

GENERAL PROVISIONS

Mailing Date

If the due date for a return falls on Saturday, Sunday, or a state holiday, the due date is automatically extended until the next business day. Returns mailed through the United States mail will be considered filed and received on the date shown in the post office cancellation mark on the envelope. If the cancellation mark is not legible or is missing, then the return will be considered filed on the date the envelope is stamped as “received” by the Department of Revenue. [Tenn. Code Ann. Section 67-1-107]

Electronic Funds Transfer (EFT)

The Tennessee General Assembly has authorized the Commissioner of Revenue to require certain tax payments to be made by funds readily available to the state. Electronic Funds Transfer is a method approved by the commissioner for accomplishing this. Rules for the administration of this legislation went into effect on January 1, 1992.

Two payment options are available that use the Automated Clearing House (ACH) system to electronically transfer tax payments. The ACH system is a nationwide network designed for this purpose and is the preferred transaction method for many financial institutions and corporations. A third payment option, Federal Wire Transfer, should be used only as an emergency option.

Penalty and interest charges may be incurred if the taxpayer fails to remit by the chosen method. No matter which method is chosen, the taxpayer must complete the Electronic Funds Transfer Agreement with the Department of Revenue.

The department will notify taxpayers that they are required to file electronically if the taxpayer’s average payment is **\$10,000** or more. A taxpayer may also choose to participate voluntarily when not required to do so. Voluntary participants are subject to the same rules and regulations as persons required to participate.

Additional information on EDI and EFT, and the required forms, may be obtained by contacting the Department of Revenue’s Electronic Commerce Unit at (866) 368-6374.

Penalties

A penalty is imposed for the late filing of a tax return and for late payment of taxes owed the state. The penalty is computed at a rate of 5% per month, or any portion of a month, from the due date until the date the taxes are paid. The maximum penalty is 25% of the tax amount due; the minimum penalty is \$15. [Tenn. Code Ann. Section 67-1-804]

The commissioner, with the concurrence of the Attorney General if the amount waived exceeds \$25,000, is authorized to waive, in whole or in part, penalties that are not the result of gross negligence or willful disregard of the law if such penalties fall within any of the good and reasonable causes for waiver set forth in the law. Interest may not be waived under any circumstances. Penalties may not be waived in situations where the taxpayer has failed to procure a license required by law unless the taxpayer can prove that failure to procure the required license was the result of erroneous advice or action on the part of officials charged with enforcement of the law. Among the good and reasonable causes for the waiver of a delinquency penalty is the fact that the taxpayer has timely filed and paid the tax in question for at least the 2 prior years. Any cause for a delinquency may be accepted as good and reasonable if it appears to the commissioner that the taxpayer has done everything that it could reasonably be expected to do, as an ordinarily intelligent and reasonably prudent business person, to timely file the return and pay the tax. Any taxpayer who believes that it has good and reasonable cause for waiver of any penalty assessed should petition the commissioner in writing for a penalty waiver. Such a petition should set forth the facts and circumstances that occasioned the deficiency or delinquency and the good and reasonable causes that the taxpayer believes warrant a waiver of the penalty assessed. [Tenn. Code Ann. Section 67-1-803]

Interest

Interest is imposed on any taxes not paid by the date required by law even though a filing date extension may have been granted. The interest charge on any returns filed late is established each July 1. Interest charges are not subject to waiver. [Tenn. Code Ann. Section 67-1-801]

FRANCHISE AND EXCISE TAXES

Audits and Assessments

All tax returns filed with the Department of Revenue undergo some type of office audit or examination to ensure that the correct tax has been paid. This audit could be a computer math audit, a manual examination by a trained auditor, or both. The taxpayer will be contacted if additional information is needed to complete the audit, and will receive written notification if any adjustments are made to the return.

Any taxpayer selected for a field audit will be contacted by the Department of Revenue to set up a convenient time for the audit. The taxpayer will receive advance notification on which records will be needed for the audit. A field audit generally involves an examination of records and documentation used to file tax returns for the previous 3 years. At the completion of the audit, the auditor will leave the taxpayer a written report for review. Once the auditor had made any necessary changes to the report, the notice of assessment for any delinquent taxes will be issued. [Tenn. Code Ann. Section 67-1-1301]

Refunds

The Commissioner of Revenue is empowered to refund taxes collected in error, including excise taxes due a taxpayer because of a decrease in net income divulged by an examination by the Internal Revenue Service. Refund requests must be supported by proper proof and must be filed within 3 years from December 31st of the year in which the tax was paid.

The commissioner may approve refunds of up to \$50,000. Refunds of greater amounts must go to the Attorney General's office for approval. [Tenn. Code Ann. Section 67-1-1802]

Dishonored Checks

If payment for taxes due is made by a check or money order that is subsequently dishonored, a penalty of 1% of the amount of the check may be imposed on the taxpayer. If a taxpayer presents the Department with three or more dishonored checks in any calendar year, the penalty will increase to 10% of the amount of the check. Regardless, the minimum amount of penalty

attached will be \$15. [Tenn. Code Ann. Section 67-1-804(d)]

Keeping Records

Every taxpayer is required to establish and maintain records that are adequate for auditors to use in determining that the correct franchise and excise taxes have been paid.

All such records shall be open for inspection, at all reasonable hours, to the Commissioner of the Department of Revenue or authorized representatives of the commissioner. [Tenn. Code Ann. Section 67-6-523]

Right to a Conference [Tenn. Code Ann. Section 67-1-1801]

Taxpayers are entitled to an informal conference to discuss an assessment. If this request is made in writing within 30 days from the date of the Notice of Assessment, the conference must be granted. If it is made beyond the 30 days, the conference may be granted within the discretion of the commissioner.

Taxpayers who wish to contest an assessment without making payment have 90 days to file suit in chancery court, as provided by statute. Interest will continue to accrue at the prevailing rate until payment is received. A lien may be filed against the taxpayer's property during this 90-day period, but the department generally may not levy on the taxpayer's property to satisfy the assessment.

If the taxpayer timely requests an informal conference, the 90-day period for filing suit stops running until a conference decision is issued in writing. After the decision is issued, the 90-day period recommences. The 90-day stay for most collection activity is likewise extended. The taxpayer is not required to request an informal conference before contesting an assessment in court.

If the taxpayer does not timely file suit to contest the assessment, the taxpayer may pay the assessment, request a refund, and then file suit in chancery court for a refund in accordance with the procedures set forth in Tenn. Code Ann. Section 67-1-1802.

FRANCHISE AND EXCISE TAXES

TENNESSEE TAXPAYER BILL OF RIGHTS

You, as a taxpayer, have certain rights. Your rights are so important that, in 1992, the Tennessee General Assembly enacted legislation to spell them out. The Tennessee Taxpayer Bill of Rights summarizes state tax laws and revenue rules with which the Department of Revenue must comply while serving you.

TAXPAYER RIGHTS [Tenn. Code Ann. Section 67-1-110]

Tennessee guarantees that you, the taxpayer, have the right to:

- Fair and courteous treatment from all employees of the Department of Revenue.
- Tax forms and information written in plain language.
- Prompt and accurate responses to all inquiries and requests for tax assistance.
- Access public records not confidential or otherwise protected by law, and to review such records at an appropriate time and location.
- Obtain all tax information relating to your account, including financial information, which is kept confidential, except to the extent required by law.
- Tax notices that clearly explain the amount being billed.
- Clear rules and procedures to resolve tax problems.
- An informal conference, as provided by law, with the Commissioner of Revenue or her delegate to dispute any tax assessment. (Taxpayers have the right to be represented by an attorney, certified public accountant, or other representative at such conference).
- Assurance that employees of the Department of Revenue are not paid, promoted, or in any way rewarded on the basis of assessments or collections.
- Suggest ways the Department of Revenue may better serve the public.
- Prompt notification of any refund to which you are entitled.
- Assistance through statewide meetings held by the Department of Revenue in convenient locations in which taxpayers are allowed to ask questions and voice opinions.
- Notice and demand for payment 10 days before the Department of Revenue makes any collection effort, except as otherwise provided by law.
- 30 days notice before seized assets are liquidated, except as otherwise provided by law.

TAXPAYER RIGHT TO A CONFERENCE [Tenn. Code Ann. Section 67-1-1801]

Taxpayers are entitled to an informal conference to discuss an assessment. If this request is made in writing within 30 days from the date of the Notice of Assessment, the conference must be granted. If it is made beyond the 30 days, the conference may be granted within the discretion of the Commissioner.

Requests for conferences may be sent by mail or fax transmittal to:

Administrative Hearing Office
Tennessee Department of Revenue
500 Deaderick Street, Room 1240
Nashville, TN 37242
Phone (615) 741-3810
Fax (615) 741-6463

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